DCP Midstream Partners, LP
Form 10-K
March 05, 2009

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended: December 31, 2008

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number: 001-32678

DCP MIDSTREAM PARTNERS, LP
(Exact name of registrant as specified in its charter)

Delaware	**03-0567133**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
370 17th Street, Suite 2775 Denver, Colorado	**80202**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code: 303-633-2900

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class:	**Name of Each Exchange on Which Registered:**
Common Units Representing Limited Partner Interests	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Exchange Act of 1934, or the Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer þ Non-accelerated filer o Smaller reporting company o
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ

The aggregate market value of common limited partner units held by non-affiliates of the registrant on June 30, 2008, was approximately $582,555,000. The aggregate market value was computed by reference to the last sale price of the registrant s common units on the New York Stock Exchange on June 30, 2008.

As of February 23, 2009, there were outstanding 28,233,183 common limited partner units.

DOCUMENTS INCORPORATED BY REFERENCE:

None.

DCP MIDSTREAM PARTNERS, LP
FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2008

TABLE OF CONTENTS

Item		Page
	PART I.	
1.	Business	2
1A.	Risk Factors	27
1B.	Unresolved Staff Comments	49
2.	Properties	49
3.	Legal Proceedings	50
4.	Submission of Matters to a Vote of Unitholders	50
	PART II.	
5.	Market for Registrant s Common Equity, Related Unitholder Matters and Issuer Purchases of Units	51
6.	Selected Financial Data	54
7.	Management s Discussion and Analysis of Financial Condition and Results of Operations	55
7A.	Quantitative and Qualitative Disclosures about Market Risk	94
8.	Financial Statements and Supplementary Data	100
9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	151
9A.	Controls and Procedures	151
9B.	Other Information	154
	PART III.	
10.	Directors, Executive Officers and Corporate Governance	154
11.	Executive Compensation	160
12.	Security Ownership of Certain Beneficial Owners and Management and Related Unitholder Matters	172
13.	Certain Relationships and Related Transactions, and Director Independence	173
14.	Principal Accounting Fees and Services	178
	PART IV.	
15.	Exhibits and Financial Statement Schedules	179
Signatures		213
Exhibit Index		215

EX-3.1
EX-10.16
EX-12.1
EX-21.1
EX-23.1
EX-23.2
EX-23.3
EX-23.4
EX-23.5
EX-31.1
EX-31.2

EX-32.1
EX-32.2
EX-99.1
EX-99.2

Table of Contents

GLOSSARY OF TERMS

The following is a list of certain industry terms used throughout this report:

Bbl	barrel
Bbls/d	barrels per day
BBtu/d	one billion Btus per day
Bcf/d	one billion cubic feet per day
Btu	British thermal unit, a measurement of energy
Fractionation	the process by which natural gas liquids are separated into individual components
Frac spread	price differences, measured in energy units, between equivalent amounts of natural gas and NGLs
MBbls	one thousand barrels
MBbls/d	one thousand barrels per day
MMBtu	one million Btus
MMBtu/d	one million Btus per day
MMcf	one million cubic feet
MMcf/d	one million cubic feet per day
MMscf	one million standard cubic feet
NGLs	natural gas liquids
Tcf	one trillion cubic feet
Throughput	the volume of product transported or passing through a pipeline or other facility

Table of Contents

CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

Our reports, filings and other public announcements may from time to time contain statements that do not directly or exclusively relate to historical facts. Such statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. You can typically identify forward-looking statements by the use of forward-looking words, such as may, could, project, believe, anticipate, expect, estimate, potential, pl other similar words.

All statements that are not statements of historical facts, including statements regarding our future financial position, business strategy, budgets, projected costs and plans and objectives of management for future operations, are forward-looking statements.

These forward-looking statements reflect our intentions, plans, expectations, assumptions and beliefs about future events and are subject to risks, uncertainties and other factors, many of which are outside our control. Important factors that could cause actual results to differ materially from the expectations expressed or implied in the forward-looking statements include known and unknown risks. Known risks and uncertainties include, but are not limited to, the risks set forth in Item 1A. Risk Factors as well as the following risks and uncertainties:

- the extent of changes in commodity prices, our ability to effectively limit a portion of the adverse impact of potential changes in prices through derivative financial instruments, and the potential impact of price on natural gas drilling, demand for our services, and the volume of NGLs and condensate extracted;
- general economic, market and business conditions;
- the level and success of natural gas drilling around our assets, and our ability to connect supplies to our gathering and processing systems in light of competition;
- our ability to grow through acquisitions, contributions from affiliates, or organic growth projects, and the successful integration and future performance of such assets;
- our ability to access the debt and equity markets, which will depend on general market conditions, interest rates and our ability to effectively limit a portion of the adverse effects of potential changes in interest rates by entering into derivative financial instruments, and the credit ratings for our debt obligations;
- our ability to purchase propane from our principal suppliers for our wholesale propane logistics business;
- our ability to construct facilities in a timely fashion, which is partially dependent on obtaining required building, environmental and other permits issued by federal, state and municipal governments, or agencies thereof, the availability of specialized contractors and laborers, and the price of and demand for supplies;
- the creditworthiness of counterparties to our transactions;
- weather and other natural phenomena, including their potential impact on demand for the commodities we sell and our third-party-owned infrastructure;
- changes in laws and regulations, particularly with regard to taxes, safety and protection of the environment or the increased regulation of our industry;

industry changes, including the impact of consolidations, increased delivery of liquefied natural gas to the United States, alternative energy sources, technological advances and changes in competition; and

the amount of collateral we may be required to post from time to time in our transactions.

In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than we have described. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Table of Contents

Item 1. *Business*

Our Partnership

DCP Midstream Partners, LP along with its consolidated subsidiaries, or we, us, our, or the partnership, is a Delaware limited partnership formed in August 2005 by DCP Midstream, LLC to own, operate, acquire and develop a diversified portfolio of complementary midstream energy assets. We completed our initial public offering on December 7, 2005. We are currently engaged in the business of gathering, compressing, treating, processing, transporting and selling natural gas, producing, transporting, storing and selling propane in wholesale markets and transporting and selling NGLs and condensate. Supported by our relationship with DCP Midstream, LLC and its parents, Spectra Energy Corp, or Spectra Energy, and ConocoPhillips, we have a management team dedicated to executing our growth strategy by acquiring and constructing additional assets.

Our operations are organized into three business segments, Natural Gas Services, Wholesale Propane Logistics and NGL Logistics. A map representing the location of the assets that comprise our segments is set forth below. Additional maps detailing the individual assets can be found on our website at *www.dcppartners.com*.

Our Natural Gas Services segment includes:

Our Northern Louisiana system, which is an integrated pipeline system located in northern Louisiana and southern Arkansas that gathers, compresses, treats, processes, transports and sells natural gas, and that transports and sells NGLs and condensate. This system consists of the following:

the Minden processing plant and gathering system, which includes a 115 MMcf/d cryogenic natural gas processing plant supplied by approximately 725 miles of natural gas gathering pipelines, connected to approximately 460 receipt points, with throughput and processing capacity of approximately 115 MMcf/d;

the Ada processing plant and gathering system, which includes a 45 MMcf/d refrigeration natural gas processing plant supplied by approximately 130 miles of natural gas gathering pipelines, connected to approximately 210 receipt points, with throughput capacity of approximately 80 MMcf/d; and

Table of Contents

the Pelico Pipeline, LLC system, or Pelico system, an approximately 600-mile intrastate natural gas gathering and transportation pipeline with throughput capacity of approximately 250 MMcf/d and connections to the Minden and Ada processing plants and approximately 450 other receipt points. The Pelico system delivers natural gas to multiple interstate and intrastate pipelines, as well as directly to industrial and utility end-use markets.

Our Southern Oklahoma, or Lindsay, gathering system, which was acquired in May 2007, consists of approximately 225 miles of pipeline, with throughput capacity of approximately 35 MMcf/d.

Our equity interests that were acquired in July 2007 from DCP Midstream, LLC, consist of the following:

our 40% interest in Discovery Producer Services LLC, or Discovery, which operates a 600 MMcf/d cryogenic natural gas processing plant, a natural gas liquids fractionator plant, an approximately 280-mile natural gas pipeline with approximate throughput capacity of 600 MMcf/d that transports gas from the Gulf of Mexico to its processing plant, and several onshore laterals expanding its presence in the Gulf; and

our 25% interest in DCP East Texas Holdings, LLC, or East Texas, which operates a 780 MMcf/d natural gas processing complex, a natural gas liquids fractionator and an approximately 900-mile gathering system with approximate throughput capacity of 780 MMcf/d, as well as third party gathering systems, and delivers residue gas to interstate and intrastate pipelines.

Our Colorado and Wyoming gathering, processing and compression assets were acquired in August 2007 from DCP Midstream, LLC, and consist of the following:

our 70% operating interest in the approximately 30-mile Collbran Valley Gas Gathering system, or Collbran system, has assets in the Piceance Basin that gather and process natural gas from over 20,000 dedicated acres in western Colorado, and a processing facility with a capacity of 120 MMcf/d; and

The Powder River Basin assets, which include the approximately 1,320-mile Douglas gas gathering system, or Douglas system, with throughput capacity of approximately 60 MMcf/d and covers more than 4,000 square miles in northeastern Wyoming, and Millis terminal, and associated NGL pipelines in southwestern Wyoming.

Our Michigan gathering and treating assets were acquired in October 2008 from Michigan Pipeline & Processing, LLC, or MPP. These assets consist of five natural gas treating plants and an approximately 155-mile gas gathering pipeline system with throughput capacity of 330 MMcf/d; an approximately 55-mile residue gas pipeline; a 75% interest in Jackson Pipeline Company, a partnership owning an approximately 25-mile residue pipeline, or Jackson Pipeline; and a 44% interest in the Litchfield pipeline, a 30-mile pipeline whereby we lease our undivided interest to ANR Pipeline Company through the use of a direct financing lease expiring in 2031.

Our Wholesale Propane Logistics segment acquired in November 2006 from DCP Midstream, LLC includes:

six owned rail terminals located in the Midwest and northeastern United States, one of which was idled in 2007 to consolidate our operations, with aggregate storage capacity of 25 MBbls;

one leased marine terminal located in Providence, Rhode Island, with storage capacity of 410 MBbls;

one pipeline terminal located in Midland, Pennsylvania with storage capacity of 56 MBbls; and

access to several open access pipeline terminals.

Our NGL Logistics segment includes:

our Seabreeze pipeline, an approximately 68-mile intrastate NGL pipeline located in Texas with throughput capacity of 33 MBbls/d;

Table of Contents

our Wilbreeze pipeline, the construction of which was completed in December 2006, an approximately 39-mile intrastate NGL pipeline located in Texas, which connects a DCP Midstream, LLC gas processing plant to the Seabreeze pipeline, with throughput capacity of 11 MBbls/d; and

our 45% interest in the Black Lake Pipe Line Company, or Black Lake, the owner of an approximately 317-mile interstate NGL pipeline in Louisiana and Texas with throughput capacity of 40 MBbls/d.

We have no revenue or segment profit or loss attributable to international activities.

For additional information on our segments, please see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, and Note 18 of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data.

Our Business Strategies

Our primary business objective is to have sustained company profitability and a strong balance sheet. In addition, we would focus on profitable growth, thereby increasing our cash distribution per unit over time. We intend to accomplish this objective by executing the following business strategies:

Optimize: maximize the profitability of existing assets. We intend to optimize the profitability of our existing assets by maintaining existing volumes and adding volumes to enhance utilization, improving operating efficiencies and capturing marketing opportunities when available. Our natural gas and NGL pipelines have excess capacity, which allows us to connect new supplies of natural gas and NGLs at minimal incremental cost. Our wholesale propane logistics business has diversified supply options that allow us to capture lower cost supply to lock in our margin, while providing reliable supplies to our customers.

Build: capitalize on organic expansion opportunities. We continually evaluate economically attractive organic expansion opportunities to construct new midstream systems in new or existing operating areas. For example, we believe there are opportunities to expand several of our gas gathering systems to attach increased volumes of natural gas produced in the areas of our operations. We also believe that we can continue to expand our wholesale propane logistics business via the construction of new propane terminals.

Acquire: pursue strategic and accretive acquisitions. We plan to pursue strategic and accretive acquisition opportunities within the midstream energy industry, both in new and existing lines of business, and geographic areas of operation. We believe there will continue to be acquisition opportunities as energy companies continue to divest their midstream assets. We intend to pursue acquisition opportunities both independently and jointly with DCP Midstream, LLC and its parents, Spectra Energy and ConocoPhillips, and we may also acquire assets directly from them, which we believe will provide us with a broader array of growth opportunities than those available to many of our competitors.

The execution of our business strategies and our level of growth is dependent upon the availability and cost of capital, as well as the availability of growth opportunities. The recent turmoil in the capital markets has resulted in significantly higher costs of public debt and equity funds.

Our Competitive Strengths

We believe that we are well positioned to execute our business strategies and achieve our primary business objective of increasing our cash distribution per unit because of the following competitive strengths:

Affiliation with DCP Midstream, LLC and its parents. Our relationship with DCP Midstream, LLC and its parents, Spectra Energy and ConocoPhillips, should continue to provide us with significant business opportunities. DCP Midstream, LLC is one of the largest gatherers of natural gas (based on wellhead volume), one of the largest producers of NGLs and one of the largest marketers of NGLs in North America. This relationship also provides us with access to a significant pool of management talent. We believe our strong relationships throughout the energy industry, including with major producers of natural gas and NGLs in the United States, will help facilitate the implementation of our strategies. Additionally, we believe DCP Midstream, LLC, which operates many of our assets on our behalf, has established a reputation in the

Table of Contents

midstream business as a reliable and cost-effective supplier of services to our customers, and has a track record of safe, efficient and environmentally responsible operation of our facilities.

Strategically located assets. Our assets are strategically located in areas that hold potential for expanding each of our business segments volume throughput and cash flow generation. Our Natural Gas Services segment has a strategic presence in several active natural gas producing areas including western Colorado, northern Louisiana, Michigan, southern Oklahoma, eastern Texas, northeastern Wyoming and the Gulf of Mexico. These natural gas gathering systems provide a variety of services to our customers including natural gas gathering, compression, treating, processing, fractionation and transportation services. The strategic location of our assets, coupled with their geographic diversity, presents us continuing opportunities to provide competitive natural gas services to our customers and opportunities to attract new natural gas production. Our NGL Logistics segment has strategically located NGL transportation pipelines in northern Louisiana, eastern Texas and southern Texas, all of which are major NGL producing regions. Our NGL pipelines connect to various natural gas processing plants in the region and transport the NGLs to large fractionation facilities, a petrochemical plant or an underground NGL storage facility along the Gulf Coast. Our Wholesale Propane Logistics Segment has terminals in the Northeastern and upper Midwestern states that are strategically located to receive and deliver propane to one of the largest demand areas for propane in the United States.

Stable cash flows. Our operations consist of a favorable mix of fee-based and commodity-based services, which together with our derivative activities, generate relatively stable cash flows. While certain of our gathering and processing contracts subject us to commodity price risk, we have mitigated a significant portion of our currently anticipated natural gas, NGL and condensate commodity price risk associated with the equity volumes from our gathering and processing operations through 2013 with fixed price natural gas and crude oil swaps. For additional information regarding our derivative activities, please read Management s Discussion and Analysis of Financial Condition and Results of Operations Quantitative and Qualitative Disclosures about Market Risk Commodity Cash Flow Protection Activities.

Integrated package of midstream services. We provide an integrated package of services to natural gas producers, including gathering, compressing, treating, processing, transporting and selling natural gas, as well as transporting and selling NGLs. We believe our ability to provide all of these services gives us an advantage in competing for new supplies of natural gas because we can provide substantially all services that producers, marketers and others require to move natural gas and NGLs from wellhead to market on a cost-effective basis.

Comprehensive propane logistics systems. We have multiple propane supply sources and terminal locations for wholesale propane delivery. We believe our diversity of supply sources and our ability to purchase large volumes of propane supply and transport such supply for resale or storage allows us to provide our customers with reliable supplies of propane during periods of tight supply. These capabilities also allow us to moderate the effects of commodity price volatility and reduce significant fluctuations in our sales volumes.

Experienced management team. Our senior management team and board of directors includes some of the most senior officers of DCP Midstream, LLC and former senior officers from other energy companies who have extensive experience in the midstream industry. Our management team has a proven track record of enhancing value through the acquisition, optimization and integration of midstream assets.

Our Relationship with DCP Midstream, LLC and its Parents

One of our principal strengths is our relationship with DCP Midstream, LLC and its parents, Spectra Energy and ConocoPhillips. DCP Midstream, LLC intends to use us as an important growth vehicle to pursue the acquisition, expansion, and existing and organic construction of midstream natural gas, NGL and other complementary energy

businesses and assets. In November 2006, we acquired our wholesale propane logistics business, in July 2007, we acquired our interest in Discovery and East Texas, and in August 2007, we acquired our Collbran and Douglas systems associated with Momentum Energy Group, Inc., or MEG, from DCP Midstream, LLC. We expect to have future opportunities to make additional acquisitions directly from DCP

Table of Contents

Midstream, LLC; however, we cannot say with any certainty which, if any, of these acquisitions may be made available to us, or if we will choose to pursue any such opportunity. In addition, through our relationship with DCP Midstream, LLC and its parents, we expect to have access to a significant pool of management talent, strong commercial relationships throughout the energy industry and DCP Midstream, LLC s broad operational, commercial, technical, risk management and administrative infrastructure.

DCP Midstream, LLC has a significant interest in our partnership through its approximately 1% general partner interest in us, all of our incentive distribution rights and a 29% limited partner interest in us. We have entered into an omnibus agreement, or the Omnibus Agreement, with DCP Midstream, LLC and some of its affiliates that governs our relationship with them regarding the operation of many of our assets, as well as certain reimbursement and indemnification matters.

Natural Gas and NGLs Overview

The midstream natural gas industry is the link between exploration and production of natural gas and the delivery of its components to end-use markets, and consists of the gathering, compression, treating, processing, transporting and selling of natural gas, and the production, transporting and selling of NGLs.

Midstream Natural Gas Industry

Once natural gas is produced from wells, producers then seek to deliver the natural gas and its components to end-use markets. The following diagram illustrates the natural gas gathering, processing, fractionation, storage and transportation process, which ultimately results in natural gas and its components being delivered to end-users.

Natural Gas Gathering

The natural gas gathering process begins with the drilling of wells into gas-bearing rock formations. Once the well is completed, the well is connected to a gathering system. Onshore gathering systems generally consist of a network of small diameter pipelines that collect natural gas from points near producing wells and transport it to larger pipelines for further transmission.

Natural Gas Compression

Gathering systems are generally operated at design pressures that will maximize the total throughput from all connected wells. Since wells produce at progressively lower field pressures as they age, it becomes increasingly difficult to deliver the remaining production from the ground against a higher pressure that exists in the connecting gathering system. Natural gas compression is a mechanical process in which a volume of wellhead gas is compressed to a desired higher pressure, allowing gas to flow into a higher pressure

Table of Contents

downstream pipeline to be brought to market. Field compression is typically used to lower the pressure of a gathering system to operate at a lower pressure or provide sufficient pressure to deliver gas into a higher pressure downstream pipeline. If field compression is not installed, then the remaining natural gas in the ground will not be produced because it cannot overcome the higher gathering system pressure. In contrast, if field compression is installed, then a well can continue delivering production that otherwise would not be produced.

Natural Gas Processing and Transportation

The principal component of natural gas is methane, but most natural gas also contains varying amounts of NGLs including ethane, propane, normal butane, isobutane and natural gasoline. NGLs have economic value and are utilized as a feedstock in the petrochemical and oil refining industries or directly as heating, engine or industrial fuels. Long-haul natural gas pipelines have specifications as to the maximum NGL content of the gas to be shipped. In order to meet quality standards for long-haul pipeline transportation, natural gas collected through a gathering system may need to be processed to separate hydrocarbon liquids from the natural gas that can have higher values as NGLs. NGLs are typically recovered by cooling the natural gas until the NGLs become separated through condensation. Cryogenic recovery methods are processes where this is accomplished at temperatures lower than minus 150°F. These methods provide higher NGL recovery yields. After being extracted from natural gas, the NGLs are typically transported via NGL pipelines or trucks to a fractionator for separation of the NGLs into their component parts.

In addition to NGLs, natural gas collected through a gathering system may also contain impurities, such as water, sulfur compounds, nitrogen or helium, which must also be removed to meet the quality standards for long-haul pipeline transportation. As a result, a natural gas processing plant will typically provide ancillary services such as dehydration and condensate separation prior to processing. Dehydration removes water from the natural gas stream, which can form ice when combined with natural gas and cause corrosion when combined with carbon dioxide or hydrogen sulfide. Natural gas with a carbon dioxide or hydrogen sulfide content higher than permitted by pipeline quality standards requires treatment with chemicals called amines at a separate treatment plant prior to processing. Condensate separation involves the removal of hydrocarbons from the natural gas stream. Once the condensate has been removed, it may be stabilized for transportation away from the processing plant via truck, rail or pipeline.

Wholesale Propane Logistics Overview

General

We are engaged in wholesale propane logistics in the midwest and northeastern United States. Wholesale propane logistics covers the receipt of propane from processing plants, fractionation facilities and crude oil refineries, the transportation of that propane by pipeline, rail or ship to terminals and storage facilities, the storage of propane and the delivery of propane to retail distributors.

Production of Propane

Propane is extracted from the natural gas stream at processing plants, separated from NGLs at fractionation facilities or separated from crude oil during the refining process. Most of the propane that is consumed in the United States is produced at processing plants, fractionation facilities and refineries located in the mid-continent, along the Texas and Louisiana Gulf Coast or in foreign locations, particularly Canada, the North Sea, East Africa and the Middle East. There are limited processing plants and fractionation facilities in the northeastern United States, and propane production is limited.

Transportation

While significant refinery production exists, propane delivery ratios are limited and refineries sometimes use propane as internal fuel during winter months. As a result, the northeastern United States is an importer of propane, relying almost exclusively on pipeline, marine and rail sources for incoming supplies.

Table of Contents

Storage

Independent terminal operators and wholesale distributors, such as us, own, lease or have access to propane storage terminals that receive supplies via pipeline, ship or rail. Generally, inventories in the propane storage facilities increase during the spring and summer months for delivery to customers during the fall and winter heating season when demand is typically at its peak.

Delivery

Often, upon receipt of propane at marine, rail and pipeline terminals, product is delivered to customer trucks or is stored in tanks located at the terminals or in off-site bulk storage facilities for future delivery to customers. Most terminals and storage facilities have a tanker truck loading facility commonly referred to as a rack. Often independent retailers will rely on independent trucking companies to pick up propane at the rack and transport it to the retailer at its location. Each truck has transport capacity of generally between 9,500 and 12,500 gallons of propane.

Natural Gas Services Segment

General

Our Natural Gas Services segment consists of a geographically diverse complement of assets and ownership interests that provide a varying array of wellhead to market services for our producer customers. These services include gathering, compressing, treating, processing, fractionating and transporting natural gas; however, we do not offer all services in every location. These assets are positioned in areas with active drilling programs and opportunities for both organic growth and readily integrated acquisitions. We operate in seven states in the continental United States: Arkansas, Colorado, Louisiana, Michigan, Oklahoma, Texas and Wyoming. The assets in these states include our Northern Louisiana system, our Southern Oklahoma system, our equity interests in Discovery and East Texas, our 70% operating interest in the Collbran system, our Douglas system, and our Michigan gathering and treating assets. The Southern Oklahoma and East Texas assets provide operating synergies and opportunities for growth in conjunction with DCP Midstream. This geographic diversity helps to mitigate our natural gas supply risk in that we are not tied to one natural gas producing area. We believe our current geographic mix of assets will be an important factor for maintaining overall volumes and cash flow for this segment.

Our Natural Gas Services segment consists of approximately 4,500 miles of pipe, five processing plants, a treating plant, two NGL fractionation facilities and over 120,000 horsepower of compression capability. The processing plants that service our natural gas gathering systems include one cryogenic facility with approximately 115 MMcf/d of processing capacity, two refrigeration style facilities with approximately 165 MMcf/d of processing capacity and two cryogenic facilities owned via equity interests with our proportionate share at approximately 435 MMcf/d of processing capacity. Further, our Minden and Discovery processing facilities both have ethane rejection capabilities that serve to optimize value of the gas stream. The combined NGL production from our processing facilities is in excess of 20,000 barrels per day and is delivered and sold into various NGL takeaway pipelines or trucked out.

The volume throughput on our assets is in excess of 830 MMcf/d from over 3,600 individual receipt points and originates from a diversified mix of natural gas producing companies. Our Southern Oklahoma, East Texas, Northern Louisiana, Discovery and Collbran systems each have significant customer acreage dedications that will continue to provide opportunities for growth as those customers execute their drilling plans over time. Our gathering systems also attract new natural gas volumes through numerous smaller acreage dedications and also by contracting with undedicated producers who are operating in or around our gathering footprint.

We have primarily a mix of percent-of-proceeds and fee-based contracts with our producing customers in our Natural Gas Services segment. Contracts at Minden, Southern Oklahoma, Douglas, Discovery and East Texas have a large component of percent-of-proceeds contracts due to the processing value of the gas streams at each of these systems. In addition, Discovery may also generate a portion of its earnings through keep-

Table of Contents

whole contracts. The Pelico, Ada, Minden, Collbran and Michigan systems are predominantly supported by fee-based contracts. This diverse contract mix is a result of contracting patterns that are largely a result of the competitive landscape in each particular geographic area.

In total, our natural gas gathering systems have the ability to deliver gas into over 20 downstream transportation pipelines and markets. Many of our outlets transport gas to premium markets in the eastern United States, further enhancing the competitiveness of our commercial efforts in and around our natural gas gathering systems.

Gathering Systems, Processing Plants and Transportation Systems

Following is operating data for our systems:

	Approximate Gas Gathering and Transmission System	Partnership Operated Plants	Plants Operated by Others	Fractionator Operated by Others	Approximate Net Plant Capacity	2008 Operating Data Natural Gas Throughput	2008 Operating Data NGL Production
System	(Miles)				(MMcf/d)	(MMcf/d)(a)	(Bbls/d)(a)
Minden	725	1			115	83	4,619
Ada	130	1			45	62	165
Pelico	600					171	
Southern Oklahoma (Lindsay)	225					18	2,203
Collbran	30	1			120	90	486
Douglas	1,320					16	1,025
Michigan	265					75	
Discovery	280		1	1	240(b)	170(b)	4,703(b)
East Texas	900		1	1	195(b)	153(b)	7,458(b)
Total	4,475	3	2	2	715	838	20,659

(a) Represents total volumes for 2008 divided by 366 days.

(b) For Discovery and East Texas, includes our 40% and 25% proportionate share, respectively, of the approximate net plant capacity, natural gas throughput and NGL production.

The Northern Louisiana natural gas gathering system includes the Minden, Ada and Pelico systems, which gather natural gas from producers at approximately 670 receipt points and deliver it for processing to the processing plants. The Minden gathering system also delivers NGLs produced at the Minden processing plant to our 45% owned Black Lake pipeline. There are 26 compressor stations located within the system, comprised of 60 units with an aggregate of approximately 70,000 horsepower. Through our Northern Louisiana system, we offer producers and customers wellhead-to-market services. The Northern Louisiana system has numerous market outlets for the natural gas we

gather, including several intrastate and interstate pipelines, major industrial end-users and major power plants. The system is strategically located to facilitate the transportation of natural gas from Texas and northern Louisiana to pipeline connections linking to markets in the eastern and northeastern areas of the United States.

The Minden processing plant is a cryogenic natural gas processing and treating plant located in Webster Parish, Louisiana. This processing plant has amine treating and ethane recovery and rejection capabilities such that we can recover approximately 80% of the ethane contained in the natural gas stream. In addition, the processing plant is able to reject the majority of the ethane when justified by market economics. This processing flexibility enables us to maximize the value of ethane for our customers. In 2002, we upgraded the Minden processing plant to enable greater ethane recovery and rejection capabilities. As part of that project, we reached an agreement with certain customers to receive 100% of the realized margin attributable to the incremental value of ethane recovered as an NGL from the natural gas stream when appropriate market conditions exist. The defined return on the initial investment for this ethane recovery upgrade was reached in 2007.

Table of Contents

The Ada gathering system is located in Bienville and Webster parishes in Louisiana and the Ada processing plant is a refrigeration natural gas processing plant located in Bienville Parish, Louisiana. This low pressure gathering system compresses and processes natural gas for our producing customers and delivers residue gas into our Pelico intrastate system. We then sell the NGLs to third-parties who truck them from the plant tailgate.

The Pelico system is an intrastate natural gas gathering and transportation pipeline that gathers and transports natural gas that does not require processing from producers in the area at approximately 450 meter locations. Additionally, the Pelico system transports processed gas from the Minden and Ada processing plants and natural gas supplied from third party interstate and intrastate natural gas pipelines. The Pelico system also receives natural gas produced in Texas through its interconnect with other pipelines that transport natural gas from Texas into western Louisiana.

The Southern Oklahoma system consists of 9,500 horsepower of compression, and approximately 350 receipt points, and is located in the Golden Trend area of McClain, Garvin and Grady counties in southern Oklahoma. The system was acquired from Anadarko Petroleum Corporation in May 2007 and is adjacent to assets owned by DCP Midstream, LLC. Currently, natural gas gathered by the system is delivered to the Oneok Maysville plant for processing; however, we will have the ability in 2009 to process the gas at a DCP Midstream, LLC processing plant to enhance our processing economics. The current Maysville connection provides marketing flexibility to multiple pipelines and access to local liquid markets using Oneok s fractionation capabilities.

The Collbran system has assets in the southern Piceance Basin that gather natural gas at high pressure from over 20,000 dedicated acres in western Colorado, and a refrigeration natural gas processing plant with a current capacity of 120 MMcf/d. Our 70% operating interest in the Collbran system was acquired from DCP Midstream, LLC in August 2007 following its acquisition of MEG. The remaining interests in the joint venture are held by Occidental Petroleum Corporation (25%) and Delta Petroleum Corporation (5%), who are also producers on the system. The processing plant was expanded in 2008 to an operating capacity to 120 MMcf/d to accommodate expected increases in volumes. The Collbran system is currently undergoing a further expansion, which is scheduled to be completed in the third quarter of 2009, consisting of an additional 24-inch pipeline loop and compression at the Anderson Gulch site. The expansion, expected to be completed in 2009, would increase the pipeline capacity to over 200 MMcf/d and enable gas deliveries to the Meeker Plant through a downstream connection with Enterprise Products Partners LP, which is also expanding its system feeding its plant. The Collbran system is designed to ultimately have throughput capacity of over 600 MMcf/d depending on future production growth.

The Douglas system has natural gas gathering pipelines that cover more than 4,000 square miles in Wyoming with over 1,300 miles of pipe. The system gathers primarily rich casing-head gas from oil wells at low pressure from approximately 650 receipt points and delivers the gas to a third party for processing under a fee agreement. The Douglas system has approximately 16,000 horsepower of compression to maintain our low pressure gathering service. The Douglas system was acquired from DCP Midstream, LLC in August 2007 following its acquisition of MEG.

We acquired MPP on October 1, 2008. These assets consist of five natural gas treating plants and an approximately 155-mile gas gathering pipeline system with throughput capacity of 330 MMcf/d; an approximately 55-mile residue gas pipeline; a 75% interest in Jackson Pipeline Company, a partnership owning an approximately 25-mile residue pipeline; and a 44% interest in the Litchfield pipeline, a 30-mile pipeline whereby we lease our undivided interest to ANR Pipeline Company through the use of a direct financing lease expiring in 2031.

We have a 40% equity interest in Discovery and the remaining 60% is owned by Williams Partners, L.P. Discovery owns (1) a natural gas gathering and transportation pipeline system located primarily off the coast of Louisiana in the Gulf of Mexico, with six delivery points connected to major interstate and intrastate pipeline systems; (2) a cryogenic natural gas processing plant in Larose, Louisiana; (3) a fractionator in Paradis, Louisiana and (4) an NGL pipeline connecting the gas processing plant to the fractionator. The Discovery system, operated by the Williams Companies,

offers a full range of wellhead-to-market services to

Table of Contents

both onshore and offshore natural gas producers. The assets are primarily located in the eastern Gulf of Mexico and Lafourche Parish, Louisiana. The Discovery system is able to reject the majority of the ethane when justified by market economics.

Discovery is managed by a two-member management committee, consisting of one representative from each owner. The members of the management committee have voting power corresponding to their respective ownership interests in Discovery. All actions and decisions relating to Discovery require the unanimous approval of the owners except for a few limited situations. Discovery must make quarterly distributions of available cash (generally, cash from operations less required and discretionary reserves) to its owners. The management committee, by majority approval based on the ownership percentage represented, will determine the amount of the distributions. In addition, the owners are required to offer to Discovery all opportunities to construct pipeline laterals within an area of interest.

Additionally, Discovery has signed definitive agreements with Chevron Corporation, Total E&P USA, Inc., and StatoilHydro ASA to construct an approximate 34-mile gathering pipeline lateral to connect Discovery s existing pipeline system to these producers production facilities for the Tahiti prospect in the deepwater region of the Gulf of Mexico. The Tahiti pipeline lateral expansion has a design capacity of approximately 200 MMcf/d. Chevron expects first production to commence in the third quarter of 2009. In conjunction with our acquisition of a 40% limited liability company interest in Discovery from DCP Midstream, LLC in July 2007, we entered into a letter agreement with DCP Midstream, LLC whereby DCP Midstream, LLC made capital contributions to us as reimbursement for remaining costs for the Tahiti pipeline lateral expansion, which were substantially completed in 2008.

We own a 25% interest in East Texas (the remaining 75% is owned by DCP Midstream, LLC), which gathers, transports, treats, compresses and processes natural gas and NGLs. The East Texas facility may also fractionate NGL production, which can be marketed at nearby petrochemical facilities. The operations, located near Carthage, Texas, include a natural gas processing complex that is connected to its gathering system, as well as third party gathering systems. The complex includes the Carthage Hub, which delivers residue gas to interstate and intrastate pipelines. The Carthage Hub acts as a key exchange point for the purchase and sale of residue gas in the eastern Texas region. The East Texas system consists of approximately 900 miles of pipe, processing capacity of 780 MMcf/d, fractionation capacity of 11,000 Bbls/d, over 25,000 horsepower of compression and serves over 1,500 receipt points in and around its geographic footprint.

East Texas is managed by a four-member management committee, consisting of two representatives from each owner. The members of the management committee have voting power corresponding to their respective ownership interests in East Texas. Most significant actions relating to East Texas require the unanimous approval of both owners. East Texas must make quarterly distributions of available cash (generally, cash from operations less required and discretionary reserves) to its owners. The management committee, by majority approval, will determine the amount of the distributions.

Natural Gas and NGL Markets

The Northern Louisiana system has numerous market outlets for the natural gas that we gather on the system. Our natural gas pipelines connect to the Perryville Market Hub, a natural gas marketing hub that provides connection to four intrastate or interstate pipelines, including pipelines owned by Southern Natural Gas Company, Texas Gas Transmission, LLC, CenterPoint Energy Mississippi River Transmission Corporation and CenterPoint Energy Gas Transmission Company. In addition, our natural gas pipelines in northern Louisiana also have access to gas that flows through pipelines owned by Texas Eastern Transmission, LP, Crosstex LIG, LLC, Gulf South Pipeline Company, Tennessee Natural Gas Company and Regency Intrastate Gas, LLC. The Northern Louisiana system is also connected to eight major industrial end-users and makes deliveries to three power plants.

The NGLs extracted from the natural gas at the Minden processing plant are delivered to our 45%-owned Black Lake pipeline through our wholly-owned approximately 9-mile Minden NGL pipeline. The Black Lake pipeline delivers NGLs to Mt. Belvieu. The NGLs extracted from natural gas at the Ada processing plant are sold at market index prices to affiliates and are delivered to third parties trucks at the tailgate of the plant.

Table of Contents

The Southern Oklahoma system has access through the Maysville processing plant to deliver gas into mid-continent transmission pipelines such as Oneok Gas Transportation and Southern Star Central Gas Pipelines, among others. When the Southern Oklahoma system delivers into the DCP Midstream, LLC owned processing plant(s) in the second quarter of 2009, a similar mix of mid-continent pipelines and markets will be available to our customers. NGLs produced from this system are delivered to Oneok Gas Transportation.

The Collbran system in western Colorado delivers gas into the TransColorado Gas Transmission interstate pipeline and to the Rocky Mountain Natural Gas LDC. The Douglas system in the Powder River basin in northeastern Wyoming delivers to the Kinder Morgan Interstate Gas Transmission interstate pipeline. The NGLs from the Collbran system are trucked off site by third party purchasers, while NGLs on the Douglas system are transported on the ConocoPhillips owned Powder River Pipeline.

The Michigan Antrim gas gathering and treating system delivers Antrim Shale gas to the South Chester Treating Complex. Antrim Shale natural gas requires treating in order to meet downstream gas pipeline quality specifications. The treated gas is transported to MichCon Gathering system from the tailgate of the plant. The Bay Area pipeline delivers fuel gas to a third party power plant owned by Consumers Energy. The Jackson Pipeline is operated by Consumers Energy and connects several intrastate pipelines with the Eaton Rapids gas storage facility. The Litchfield pipeline is operated by ANR Pipeline Company and facilitates receipts or deliveries between ANR Pipeline Company and the Eaton Rapids storage facility. All Michigan assets were acquired from MPP on October 1, 2008.

The Discovery assets have access to downstream pipelines and markets including Texas Eastern Transmission Company, Bridgeline, Gulf South Pipeline Company, Transcontinental Gas Pipeline Company, Columbia Gulf Transmission and Tennessee Gas Pipeline Company, among others. The NGLs are fractionated at the Paradis fractionation facilities and delivered downstream to third-party purchasers. The third party purchasers of the fractionated NGLs consist of a mix of local petrochemical facilities and wholesale distribution companies for the ethane and propane components, while the butanes and natural gasoline are delivered and sold to pipelines that transport product to the storage and distribution center near Napoleonville, Louisiana or other similar product hub.

The East Texas system delivers gas primarily to the Carthage Hub which delivers residue gas to ten different interstate and intrastate pipelines including Centerpoint Energy Gas Transmission, Texas Gas Transmission, Tennessee Gas Pipeline Company, Natural Gas Pipeline Company of America, Gulf South Pipeline Company, Enterprise and others. Certain of the lighter NGLs, consisting of ethane and propane, are fractionated at the East Texas facility and sold to regional petrochemical purchasers. The remaining NGLs, including butanes and natural gasoline, are purchased by DCP Midstream, LLC and shipped on the Panola NGL pipeline to Mont Belvieu for fractionation and sale.

Customers and Contracts

The primary suppliers of natural gas to our Natural Gas Services segment are a broad cross-section of the natural gas producing community. We actively seek new producing customers of natural gas on all of our systems to increase throughput volume and to offset natural declines in the production from connected wells. We obtain new natural gas supplies in our operating areas by contracting for production from new wells, by connecting new wells drilled on dedicated acreage and by obtaining natural gas that has been directly received or released from other gathering systems.

We had no third-party customers in our Natural Gas Services segment that accounted for greater than 10% of our revenues.

Our contracts with our producing customers in our Natural Gas Services segment are primarily a mix of commodity sensitive percent-of-proceeds contracts and non-commodity sensitive fee-based contracts. Generally, the initial term of

these purchase agreements is for three to five years or, in some cases, the life of the lease. The largest percentage of volume at Minden, Southern Oklahoma, Douglas and East Texas are processed under percent-of-proceeds contracts. Discovery has percent-of-proceeds contracts and fee-based contracts, as well as some keep-whole contracts. The majority of the contracts for our Pelico, Ada, Collbran and Michigan

Table of Contents

systems are fee-based agreements. Our gross margin generated from percent-of-proceeds contracts is directly correlated to the price of natural gas, NGLs and condensate.

The midstream natural gas industry is cyclical, with the operating results of companies in the industry significantly affected by the prevailing price of NGLs, which in turn has been generally correlated to the price of crude oil, except in recent periods, when NGL pricing has been at a greater discount to crude oil pricing. Although the prevailing price of residue natural gas has less short-term significance to our operating results than the price of NGLs, in the long term the growth and sustainability of our business depends on natural gas prices being at levels sufficient to provide incentives and capital for producers to increase natural gas exploration and production. The prices of NGLs, crude oil and natural gas can be extremely volatile for periods of time, and may not always have a close correlation. Changes in the correlation of the price of NGLs and crude oil may cause our commodity price sensitivities to vary. To minimize potential future commodity-based pricing and cash flow volatility, we have entered into a series of derivative financial instruments. As a result of these transactions, we have mitigated a significant portion of our expected natural gas, NGL and condensate commodity price risk relating to the equity volumes associated with our gathering and processing operations through 2013.

Discovery s wholly owned subsidiary, Discovery Gas Transmission, owns the mainline and the Federal Energy Regulatory Commission, or FERC-regulated laterals, which generate revenues through a tariff on file with the FERC for several types of service: traditional firm transportation service with reservation fees (although no current shippers have elected this service); firm transportation service on a commodity basis with reserve dedication; and interruptible transportation service. In addition, for any of these general services, Discovery Gas Transmission has the authority to negotiate a specific rate arrangement with an individual shipper and has several of these arrangements currently in effect.

Competition

Competition in our Natural Gas Services segment is highly competitive in our markets and includes major integrated oil and gas companies, interstate and intrastate pipelines, and companies that gather, compress, treat, process, transport and/or market natural gas. Competition is often the greatest in geographic areas experiencing robust drilling by producers and during periods of high commodity prices for crude oil, natural gas and/or natural gas liquids. Competition is also increased in those geographic areas where our commercial contracts with our customers are shorter in length of term and therefore must be renegotiated on a more frequent basis.

Wholesale Propane Logistics Segment

General

We operate a wholesale propane logistics business in the states of Connecticut, Maine, Massachusetts, New Hampshire, New York, Ohio, Pennsylvania, Rhode Island and Vermont.

Due to our multiple propane supply sources, annual and long-term propane supply purchase arrangements, significant storage capabilities, and multiple terminal locations for wholesale propane delivery, we are generally able to provide our retail propane distribution customers with reliable, low cost deliveries and greater volumes of propane during periods of tight supply such as the winter months. We believe these factors generally allow us to maintain favorable relationships with our customers.

These factors have allowed us to remain a supplier to many of the large retail distributors in the northeastern United States. As a result, we serve as the baseload provider of propane supply to many of our retail propane distribution customers.

We manage our wholesale propane margins by selling propane to retail propane distributors under annual sales agreements negotiated each spring that specify floating price terms that provide us a margin in excess of our floating index-based supply costs under our supply purchase arrangements. In the event that a retail propane distributor desires to purchase propane from us on a fixed price basis, we sometimes enter into fixed price sales agreements with terms of generally up to one year, and we manage this commodity price risk by entering into either offsetting physical purchase agreements or financial derivative instruments, with either

Table of Contents

DCP Midstream, LLC or third parties, that generally match the quantities of propane subject to these fixed price sales agreements. The financial derivatives are accounted for using mark-to-market accounting. Our portfolio of multiple supply sources and storage capabilities allows us to actively manage our propane supply purchases and to lower the aggregate cost of supplies. Based on the carrying value of our inventory, timing of inventory transactions and the volatility of the market value of propane, we have historically and may continue to periodically recognize non-cash lower of cost or market inventory adjustments. In addition, we may, on occasion, use financial derivatives to manage the value of our propane inventories.

Pipeline deliveries to the northeast market in the winter season are generally at capacity and competing pipeline dependent terminals can have supply constraints or outages during peak market conditions. Our system of terminals has substantial excess capacity, which provides us with opportunities to increase our volumes with minimal additional cost. Additionally, we constructed a propane pipeline terminal located in Midland, Pennsylvania that became operational in May 2007, and we are actively seeking new terminals through acquisition or construction to expand our distribution capabilities, subject to the availability of capital.

Our Terminals

Our operations include six propane rail terminals with aggregate storage capacity of 25 MBbls, one of which was idled in 2007 to consolidate our operations, one propane marine terminal with storage capacity of 410 MBbls, one propane pipeline terminal with storage capacity of 56 MBbls and access to several open access pipeline terminals. We own our rail terminals and lease the land on which the terminals are situated under long-term leases, except for the York terminal where we own the land. The marine terminal is leased on a long-term lease agreement. Each of our rail terminals consist of two to three propane tanks with capacity of between 120,000 and 270,000 gallons for storage, and two high volume loading racks for loading propane into trucks. Our aggregate truck-loading capacity is approximately 400 trucks per day. We could expand each of our terminals loading capacity by adding a third loading rack to handle future growth. High volume submersible pumps are utilized to enable trucks to fully load within 15 minutes. Each facility also has the ability to unload multiple railcars simultaneously. We have numerous railcar leases that allow us to increase our storage and throughput capacity as propane demand increases. Each terminal relies on leased rail trackage for the storage of the majority of its propane inventory in these leased railcars. These railcars mitigate the need for larger numbers of fixed storage tanks and reduce initial capital needs when constructing a terminal. Each railcar holds approximately 30,000 gallons of propane.

We are also actively seeking to expand and favorably position our wholesale propane distribution business into the upper Midwest and Mid-Atlantic states, and have constructed a propane pipeline terminal in western Pennsylvania that became operational in May 2007.

Propane Supply

Our wholesale propane business has a strategic network of supply arrangements under annual and multi-year agreements under index-based pricing. The remaining supply is purchased on annual or month-to-month terms to match our anticipated sale requirements. During 2008, our primary suppliers of propane included a subsidiary of DCP Midstream, LLC, Aux Sable Liquid Products LP and Spectra Energy. During 2007, our primary suppliers of propane included Shell International Trading and Shipping Company, Aux Sable Liquid Products LP and a subsidiary of DCP Midstream, LLC.

For our rail terminals, we contract for propane at various major supply points in the United States and Canada, and transport the product to our terminals under long-term rail commitments, which provide fixed transportation costs that are subject to prevailing fuel surcharges. We also purchase propane supply from natural gas fractionation plants and crude oil refineries located in the Texas and Louisiana Gulf Coast. Through this process, we take custody of the

propane and either sell it in the wholesale market or store it at our facilities. For our marine terminal, we have historically contracted under annual agreements for delivered shipments of propane. In May 2008, we entered into a long term contract with Spectra Energy that offers both product and shipping capabilities. The port where the marine terminal facility is located has been expanded, and we can now receive propane supply from larger propane tankers.

Table of Contents

Customers and Contracts

We typically sell propane to retail propane distributors under annual sales agreements negotiated each spring that specify floating price terms that provide us a margin in excess of our floating index-based supply costs under our supply purchase arrangements. In the event that a retail propane distributor desires to purchase propane from us on a fixed price basis, we sometimes enter into fixed price sales agreements with terms of generally up to one year. We manage this commodity price risk by entering into either offsetting physical purchase agreements or financial derivative instruments, with DCP Midstream, LLC or third parties that generally match the quantities of propane subject to these fixed price sales agreements. Our ability to help our clients manage their commodity price exposure by offering propane at a fixed price may lead to a larger customer base. Historically, approximately 75% of the gross margin generated by our wholesale propane business is earned in the heating season months of October through April, which corresponds to the general market demand for propane.

We had no third-party customers in our Wholesale Propane Logistics segment that accounted for greater than 10% of our revenues.

Competition

The wholesale propane business is highly competitive in the upper midwest and northeastern regions of the United States. Our wholesale propane business competitors include major integrated oil and gas and energy companies, and interstate and intrastate pipelines.

NGL Logistics Segment

General

We operate our NGL Logistics business in the states of Louisiana and Texas.

Our NGL transportation assets consist of our wholly-owned approximately 68-mile Seabreeze intrastate NGL pipeline and our wholly-owned approximately 39-mile Wilbreeze intrastate NGL pipeline, both of which are located in Texas, and a 45% interest in the approximately 317-mile Black Lake interstate NGL pipeline located in Louisiana and Texas. These NGL pipelines transport NGLs from natural gas processing plants to fractionation facilities, a petrochemical plant and an underground NGL storage facility. In aggregate, our NGL transportation business has 73 MBbls/d of capacity and in 2008 average throughput was approximately 31 MBbls/d.

Our pipelines provide transportation services to customers on a fee basis. Therefore, the results of operations for this business are generally dependent upon the volume of product transported and the level of fees charged to customers. The volumes of NGLs transported on our pipelines are dependent on the level of production of NGLs from processing plants connected to our NGL pipelines. When natural gas prices are high relative to NGL prices, it is less profitable to recover NGLs from natural gas because of the higher value of natural gas compared to the value of NGLs. As a result, we have experienced periods in the past, and will likely experience periods in the future, when higher natural gas prices reduce the volume of NGLs produced at plants connected to our NGL pipelines.

NGL Pipelines

Seabreeze and Wilbreeze Pipelines. The Seabreeze pipeline has capacity of 33 MBbls/d and for 2008 average throughput on the pipeline was approximately 17 MBbls/d. The Seabreeze pipeline was put into service in 2002 to deliver NGLs to a large processing plant with capacity of approximately 340 MMcf/d located in Matagorda County, and a NGL pipeline. The Seabreeze pipeline also delivered to a second plant, which was closed during 2008. The

Seabreeze pipeline is the sole NGL pipeline for one processing plant and is the only delivery point for two NGL pipelines. One third party NGL pipeline transports NGLs from five natural gas processing plants located in southeastern Texas that have aggregate processing capacity of approximately 1.6 Bcf/d. Three of these processing plants are owned by DCP Midstream, LLC. In total seven processing plants produce NGLs that flow into the Seabreeze pipeline from processed natural gas produced in

Table of Contents

southern Texas and offshore in the Gulf of Mexico. The Seabreeze pipeline delivers the NGLs it receives from these sources to a fractionator and a storage facility. We completed construction of our Wilbreeze pipeline in December 2006. Current capacity of the Wilbreeze pipeline is 11 MBbls/d and average throughput on the pipeline was approximately 6 MBbls/d for 2008.

Black Lake Pipeline. The Black Lake pipeline has capacity of 40 MBbls/d and for 2008, average throughput on the Black Lake pipeline at our 45% interest was approximately 8 MBbls/d. The Black Lake pipeline was constructed in 1967 and delivers NGLs from processing plants in northern Louisiana and southeastern Texas to fractionation plants at Mont Belvieu on the Texas Gulf Coast. The Black Lake pipeline receives NGLs from three natural gas processing plants in northern Louisiana, including our Minden plant, Regency Intrastate Gas, LLC s Dubach processing plant and Chesapeake Energy Corporation s Black Lake processing plant. The Black Lake pipeline is the sole NGL pipeline for all of these natural gas processing plants in northern Louisiana, as well as the Ceritas South Raywood processing plant located in southeastern Texas, and also receives NGLs from XTO Energy Inc. s Cotton Valley processing plant. In addition, the Black Lake pipeline receives NGLs from a natural gas processing plant located in southeastern Texas.

There are currently five significant active shippers on the pipeline, with DCP Midstream, LLC historically being the largest, representing approximately 47% of total throughput in 2008. The Black Lake pipeline generates revenues through a FERC-regulated tariff, and the average rate per barrel was $1.00 in 2008, $0.95 in 2007 and $0.94 in 2006.

Black Lake is a partnership that is operated by and 50% owned by BP PLC. Black Lake is required by its partnership agreement to make monthly cash distributions equal to 100% of its available cash for each month, which is defined generally as receipts plus reductions in cash reserves less disbursements and increases in cash reserves. In anticipation of a pipeline integrity project, Black Lake suspended making monthly cash distributions in December 2004 in order to reserve cash to pay the expenses of this project. This project was completed and cash distributions resumed during 2008.

Customers and Contracts

The Wilbreeze pipeline is supported by an NGL product dedication agreement with DCP Midstream, LLC.

Effective December 1, 2005, we entered into a contractual arrangement with a subsidiary of DCP Midstream, LLC that provides that DCP Midstream, LLC will purchase the NGLs that were historically purchased by us, and DCP Midstream, LLC will pay us to transport the NGLs pursuant to a fee-based rate that will be applied to the volumes transported. We have entered into this fee-based contractual arrangement with the objective of generating approximately the same operating income per barrel transported that we realized when we were the purchaser and seller of NGLs. We do not take title to the products transported on the NGL pipelines; rather, the shipper retains title and the associated commodity price risk. DCP Midstream, LLC is the sole shipper on the Seabreeze pipeline under a long-term transportation agreement. The Seabreeze pipeline only collects fee-based transportation revenue under this agreement. DCP Midstream, LLC receives its supply of NGLs that it then transports on the Seabreeze pipeline under an NGL purchase agreement with Williams. Under this agreement, Williams has dedicated all of their respective NGL production from this processing plant to DCP Midstream, LLC. DCP Midstream, LLC has a sales agreement with Formosa. Additionally, DCP Midstream, LLC has a transportation agreement with TEPPCO Partners, L.P. that covers all of the NGL volumes transported on TEPPCO Partners, L.P. s South Dean NGL pipeline for delivery to the Seabreeze pipeline.

We had no third-party customers in our NGL Logistics segment that accounted for greater than 10% of our revenues.

Safety and Maintenance Regulation

We are subject to regulation by the United States Department of Transportation, or DOT, under the Hazardous Liquids Pipeline Safety Act of 1979, as amended, referred to as the Hazardous Liquid Pipeline

Table of Contents

Safety Act, and comparable state statutes with respect to design, installation, testing, construction, operation, replacement and management of pipeline facilities. The Hazardous Liquid Pipeline Safety Act covers petroleum and petroleum products, including NGLs and condensate, and requires any entity that owns or operates pipeline facilities to comply with such regulations, to permit access to and copying of records and to file certain reports and provide information as required by the United States Secretary of Transportation. These regulations include potential fines and penalties for violations. We believe that we are in material compliance with these Hazardous Liquid Pipeline Safety Act regulations.

We are also subject to the Natural Gas Pipeline Safety Act of 1968, as amended, or NGPSA, and the Pipeline Safety Improvement Act of 2002. The NGPSA regulates safety requirements in the design, construction, operation and maintenance of gas pipeline facilities while the Pipeline Safety Improvement Act establishes mandatory inspections for all United States oil and natural gas transportation pipelines in high-consequence areas within 10 years. The DOT has developed regulations implementing the Pipeline Safety Improvement Act that requires pipeline operators to implement integrity management programs, including more frequent inspections and other safety protections in areas where the consequences of potential pipeline accidents pose the greatest risk to people and their property. We currently estimate we will incur costs of approximately $2.0 million between 2009 and 2013 to implement integrity management program testing along certain segments of our natural gas transmission and NGL pipelines. This does not include the costs, if any, of repair, remediation, preventative or mitigating actions that may be determined to be necessary as a result of the testing program. DCP Midstream, LLC agreed to indemnify us for up to $5.3 million of our pro rata share of any capital contributions associated with repairing the Black Lake pipeline that are determined to be necessary as a result of the pipeline integrity testing. We anticipate repairs of approximately $0.8 million on the pipeline, which will be funded directly from Black Lake. We will not make contributions to Black Lake to cover these expenses.

States are largely preempted by federal law from regulating pipeline safety but may assume responsibility for enforcing intrastate pipeline regulations at least as stringent as the federal standards. In practice, states vary considerably in their authority and capacity to address pipeline safety. We do not anticipate any significant problems in complying with applicable state laws and regulations in those states in which we or the entities in which we own an interest operate. Our natural gas transmission and regulated gathering pipelines have ongoing inspection and compliance programs designed to keep the facilities in compliance with pipeline safety and pollution control requirements.

In addition, we are subject to the requirements of the federal Occupational Safety and Health Act, or OSHA, and comparable state statutes, whose purpose is to protect the health and safety of workers, both generally and within the pipeline industry. In addition, the OSHA hazard communication standard, the Environmental Protection Agency, or EPA, community right-to-know regulations under Title III of the federal Superfund Amendment and Reauthorization Act and comparable state statutes require that information be maintained concerning hazardous materials used or produced in our operations and that this information be provided to employees, state and local government authorities and citizens. We and the entities in which we own an interest are also subject to OSHA Process Safety Management regulations, which are designed to prevent or minimize the consequences of catastrophic releases of toxic, reactive, flammable or explosive chemicals. These regulations apply to any process which involves a chemical at or above the specified thresholds, or any process which involves flammable liquid or gas, pressurized tanks, caverns and wells in excess of 10,000 pounds at various locations. Flammable liquids stored in atmospheric tanks below their normal boiling point without the benefit of chilling or refrigeration are exempt. We have an internal program of inspection designed to monitor and enforce compliance with worker safety requirements. We believe that we are in material compliance with all applicable laws and regulations relating to worker health and safety.

Propane Regulation

National Fire Protection Association Pamphlets No. 54 and No. 58, which establish rules and procedures governing the safe handling of propane, or comparable regulations, have been adopted as the industry standard in all of the states in which we operate. In some states these laws are administered by state agencies, and in others they are administered on a municipal level. With respect to the transportation of propane by truck, we

Table of Contents

are subject to regulations promulgated under the Federal Motor Carrier Safety Act. These regulations cover the transportation of hazardous materials and are administered by the DOT. We conduct ongoing training programs to help ensure that our operations are in compliance with applicable regulations. We maintain various permits that are necessary to operate our facilities, some of which may be material to our propane operations. We believe that the procedures currently in effect at all of our facilities for the handling, storage and distribution of propane are consistent with industry standards and are in compliance in all material respects with applicable laws and regulations.

FERC Regulation of Operations

FERC regulation of pipeline gathering and transportation services, natural gas sales and transportation of NGLs may affect certain aspects of our business and the market for our products and services.

Interstate Natural Gas Pipeline Regulation

The Discovery 105-mile mainline, approximately 60 miles of laterals and its market expansion project are subject to regulation by FERC, under the Natural Gas Act of 1938, or NGA. Natural gas companies may not charge rates that have been determined not to be just and reasonable. In addition, the FERC s authority over natural gas companies that provide natural gas pipeline transportation services in interstate commerce includes:

certification and construction of new facilities;

extension or abandonment of services and facilities;

maintenance of accounts and records;

acquisition and disposition of facilities;

initiation and discontinuation of services;

terms and conditions of services and service contracts with customers;

depreciation and amortization policies;

conduct and relationship with certain affiliates; and

various other matters.

Generally, the maximum filed recourse rates for interstate pipelines are based on the cost of service including recovery of and a return on the pipeline s actual prudent historical cost investment. Key determinants in the ratemaking process are costs of providing service, allowed rate of return and volume throughput and contractual capacity commitment assumptions. The maximum applicable recourse rates and terms and conditions for service are set forth in each pipeline s FERC approved tariff. Rate design and the allocation of costs also can impact a pipeline s profitability. FERC-regulated natural gas pipelines are permitted to discount their firm and interruptible rates without further FERC authorization down to the variable cost of performing service, provided they do not unduly discriminate.

Tariff changes can only be implemented upon approval by the FERC. Two primary methods are available for changing the rates, terms and conditions of service of an interstate natural gas pipeline. Under the first method, the pipeline voluntarily seeks a tariff change by making a tariff filing with the FERC justifying the proposed tariff change and providing notice, generally 30 days, to the appropriate parties. If the FERC determines that a proposed change is

just and reasonable as required by the NGA, the FERC will accept the proposed change and the pipeline will implement such change in its tariff. However, if the FERC determines that a proposed change may not be just and reasonable as required by the NGA, then the FERC may suspend such change for up to five months beyond the date on which the change would otherwise go into effect and set the matter for an administrative hearing. Subsequent to any suspension period ordered by the FERC, the proposed change may be placed into effect by the company, pending final FERC approval. In most cases, a proposed rate increase is placed into effect before a final FERC determination on such rate increase, and the proposed increase is collected subject to refund (plus interest). Under the second method, the FERC may, on

Table of Contents

its own motion or based on a complaint, initiate a proceeding seeking to compel the company to change its rates, terms and/or conditions of service. If the FERC determines that the existing rates, terms and/or conditions of service are unjust, unreasonable, unduly discriminatory or preferential, then any rate reduction or change that it orders generally will be effective prospectively from the date of the FERC order requiring this change.

In November 2003, the FERC issued Order 2004 governing the Standards of Conduct for Transmission Providers (including natural gas interstate pipelines). These standards provide that interstate pipeline employees engaged in natural gas transmission system operations must function independently from any employees of their energy affiliates and marketing affiliates and that an interstate pipeline must treat all transmission customers, affiliated and non-affiliated, on a non-discriminatory basis, and cannot operate its transmission system to benefit preferentially, an energy or marketing affiliate. In addition, Order 2004 restricts access to natural gas transmission customer data by marketing and other energy affiliates and provides certain conditions on service provided by interstate pipelines to their gas marketing and energy affiliates. In November 2006, the United States Court of Appeals for the District of Columbia Circuit, or D.C. Circuit, vacated Order 2004 as that order applies to interstate natural gas pipelines and remanded that proceeding to the FERC for further action.

On January 9, 2007, the FERC issued Order 690 in response to the D.C. Circuit s decision. In its Order, the Commission issued new interim standards of conduct pending the outcome of a new rulemaking proceeding. The interim standards only govern the relationship between an interstate pipeline and its marketing affiliates as opposed to its energy affiliates, the latter being a much broader category as originally set forth in Order 2004. As a result, the Commission effectively repromulgated on a temporary basis the Standards of Conduct first issued in Order 497 in 1992, while it considers its course of action to address the court s decision on a more permanent basis.

On January 18, 2007, the FERC issued a Notice of Proposed Rulemaking or 2007 NOPR in Docket No. RM07-1 wherein it proposes to make permanent its interim standards of conduct issued in Order 690. The Commission also sought comment as to whether it should make comparable changes to the electric industry standards of conduct that were not affected by either the November 2006 decision by the D.C. Circuit, or by Order 690, as well as comments regarding certain other electric-related exceptions to Order 2004. We continue to closely monitor these proceedings and administer our compliance programs accordingly.

On March 21, 2008, FERC issued an NOPR to revise the Standards of Conduct to make them clearer and to refocus the rules on the areas where there is the greatest potential for affiliate abuse, or 2008 NOPR. The 2008 NOPR replaces the 2007 NOPR. The 2008 NOPR applies the Standards of Conduct to any interstate natural gas pipeline that conducts transportation transactions with an affiliate that engages in marketing functions. The definition of marketing function exempts sales from gathering and processing facilities.

On October 16, 2008, FERC issued Order No. 717 providing a final rule on the FERC Standards of Conduct that conforms to the U.S. Court of Appeals Decision. The final rule applies the Standards of Conduct to interstate natural gas pipelines that conduct transportation transactions with an affiliate that engages in marketing functions. Under the final rule, interstate pipeline transmission information is restricted from being disclosed to the affiliate s marketing function employees. The definition of marketing function employees is limited to those employees engaged on a day-to-day basis in the sale for resale of natural gas in interstate commerce. The FERC Standards of Conduct do not apply to Discovery under the final rule.

The Outer Continental Shelf Lands Act, or OCSLA, requires that all pipelines operating on or across the outer continental shelf, or OCS, provide open access, non-discriminatory transportation service. In an effort to heighten its oversight of transportation on the OCS, the FERC attempted to promulgate reporting requirements with respect to OCS transportation, but the regulations were struck down as ultra vires by a federal district court, which decision was affirmed by the D.C. Circuit in October 2003. The FERC withdrew those regulations in March 2004. Subsequently, in

April 2004, the Minerals Management Service, or MMS, initiated an inquiry into whether it should amend its regulations to assure that pipelines provide open and non-discriminatory access over OCS pipeline facilities. In April 2007, the MMS issued a notice of proposed rulemaking that would establish a process for a shipper transporting oil or gas production from OCS leases to follow if it

Table of Contents

believes it has been denied open and nondiscriminatory access to OCS pipelines. However, the proposed rule makes clear that the MMS will defer to FERC with respect to pipelines subject to FERC s NGA and Interstate Commerce Act jurisdiction, stating that the MMS would not consider complaints regarding a FERC pipeline that, for example, originates from a lease on the OCS and then transports production onshore to an adjacent state. The MMS has also proposed a regulation providing for civil penalties of up to $10,000 per day for violations of the OCSLA s open and nondiscriminatory access requirements. On June 18, 2008, the MMS issued a final rule regarding open and nondiscriminatory access to pipelines on the OCS that is generally consistent with the NOPR. The final rule did institute a time limit of two years from the time of the denial of open access for initiating a formal complaint. The final rule is effective August 18, 2008. We do not expect that the final rule will affect our OCS operations.

On July 19, 2007, FERC issued a proposed policy statement regarding the appropriate composition of proxy groups for purposes of determining natural gas and oil pipeline equity returns to be included in cost-of-service based rates. FERC proposed to permit inclusion of publicly traded partnerships in the proxy group analysis relating to return on equity determinations in rate proceedings, provided that the analysis be limited to actual publicly traded partnership distributions capped at the level of the pipeline s earnings and that evidence be provided in the form of a multiyear analysis of past earnings demonstrating a publicly traded partnership s ability to provide stable earnings over time. On November 15, 2007, the FERC requested additional comments regarding the method to be used for creating growth forecasts for publicly traded partnerships, and FERC held a technical conference on this issue in January 2008. On April 17, 2008, FERC issued a final policy statement regarding the appropriate composition of proxy groups. FERC concluded, among other things, that MLPs should be included in the Return on Equity or ROE proxy group for both oil and gas pipelines. FERC established a paper hearing for establishing the ROE for cases that were pending before FERC. The policy statement could result in the establishment of a higher ROE in future rate proceedings but the full effect is uncertain until the policy is applied.

On September 20, 2007, FERC issued a Notice of Inquiry regarding Fuel Retention Practices of Natural Gas Pipelines (Fuel NOI). The Fuel NOI inquires whether the current policy which allows natural gas pipelines to choose between two options for recovering the costs of fuel and lost and unaccounted for (LAUF) gas should be changed in favor of a uniform method. Comments have been filed in response to the Fuel NOI. On November 20, 2008, FERC terminated this proceeding and declined making any changes to the fuel retention practices of natural gas pipelines.

On September 20, 2007, FERC issued a Notice of Proposed Rulemaking regarding Revisions to Forms, Statements, and Reporting Requirements for Natural Gas Pipelines (Reporting NOPR). The Reporting NOPR proposed to require pipelines to (i) provide additional information regarding their sources of revenue and amounts included in rate base; (ii) identify costs related to affiliate transactions; and (iii) provide additional information regarding incremental facilities, and discounted and negotiated rates. According to FERC, the changes would assist pipeline customers and other third parties in analyzing a pipeline s actual return as compared with its approved rate of return based on publicly filed data. On March 21, 2008, FERC issued Order No. 710 implementing revisions to the forms, statements and reporting requirements of natural gas pipelines. The order is effective on January 1, 2008 and impacts the 2008 FERC Form 2 and subsequent Form 3-Qs. The final rule generally adopts the changes provided in the Reporting NOPR. While the revisions will require additional time in the development of the report, the impact of the final rule is not expected to be material to Discovery.

On November 15, 2007, FERC issued a notice of proposed rulemaking proposing to permit market-based pricing for short-term capacity releases and to facilitate asset management arrangements by relaxing FERC s prohibition on tying and on its bidding requirements for certain capacity releases (Capacity Release NOPR). FERC proposes to lift the price ceiling for short-term capacity release transactions of one year or less. The Capacity Release NOPR is proposed to enable releasing shippers to offer competitively-priced alternatives to pipelines negotiated rates and to encourage more efficient construction of capacity. Under FERC s proposal, it is possible for the releasing shipper to release the natural gas at market-based prices while pipelines would still be subject to the maximum rate cap. On June 19, 2008,

FERC issued Order No. 712 implementing revised capacity release rules that revised the capacity release regulations consistent with the Capacity Release NOPR.

Table of Contents

The most significant modification was to allow for capacity releases of one year or less to be awarded to the highest rate, without regard to the maximum rate. The impact of this rule to Discovery should be immaterial.

On December 21, 2007, FERC issued a notice of proposed rulemaking which proposes to require interstate natural gas pipelines and certain non-interstate natural gas pipelines to post capacity, daily scheduled flow information, and daily actual flow information. On November 20, 2008, FERC issued Order No. 720, a final rule adopting new regulations that require certain major non-interstate pipelines and interstate pipelines to publicly post certain operational and scheduling information. Interstate pipelines must post the volumes of no-notice transportation flows at each receipt and delivery point before 11:30 a.m. central clock time three days after the day of gas flow. The final rule requires interstate pipelines to post less information than under the proposed rule. The final rule does not apply to Discovery.

Additional proposals and proceedings that might affect the natural gas industry are pending before Congress, the FERC and the courts. The natural gas industry historically has been heavily regulated; therefore, there is no assurance that a more stringent regulatory approach will not be pursued by the FERC and Congress, especially in light of potential market power abuse by marketing affiliates of certain pipeline companies engaged in interstate commerce. In response to this issue, Congress, in the Energy Policy Act of 2005 (EPACT 2005), and the FERC have implemented requirements to ensure that energy prices are not impacted by the exercise of market power or manipulative conduct. EPACT 2005 prohibits the use of any manipulative or deceptive device or contrivance in connection with the purchase or sale of natural gas, electric energy or transportation subject to the FERC s jurisdiction. The FERC then adopted the Market Manipulation Rules and the Market Behavior Rules to implement the authority granted under EPACT 2005. These rules, which prohibit fraud and manipulation in wholesale energy markets, are very vague and are subject to broad interpretation. Only two orders interpreting these rules have been issued to date, and each of these is subject to further proceedings. These orders reflect the FERC s view that it has broad latitude in determining whether specific behavior violates the rules. In addition, EPACT 2005 gave the FERC increased penalty authority for these violations. The FERC may now issue civil penalties of up to $1 million per day for each violation of FERC rules, and there are possible criminal penalties of up to $1 million and 5 years in prison. Given the FERC s broad mandate granted in EPACT 2005, it is assumed that if energy prices are high, or exhibit what the FERC deems to be unusual trading patterns, the FERC will investigate energy markets to determine if behavior unduly impacted or manipulated energy prices.

Intrastate Natural Gas Pipeline Regulation

Intrastate natural gas pipeline operations are not generally subject to rate regulation by FERC, but they are subject to regulation by various agencies in the respective states where they are located. While the regulatory regime varies from state to state, state agencies typically require intrastate gas pipelines to file their rates with the agencies and permit shippers to challenge existing rates or proposed rate increases. However, to the extent that an intrastate pipeline system transports natural gas in interstate commerce, the rates, terms and conditions of such transportation service are subject to FERC jurisdiction under Section 311 of the Natural Gas Policy Act, or NGPA. Under Section 311, intrastate pipelines providing interstate service may avoid jurisdiction that would otherwise apply under the NGA. Section 311 regulates, among other things, the provision of transportation services by an intrastate natural gas pipeline on behalf of a local distribution company or an interstate natural gas pipeline. Under Section 311, rates charged for transportation must be fair and equitable, and amounts collected in excess of fair and equitable rates are subject to refund with interest. Rates for service pursuant to Section 311 of the NGPA are generally subject to review and approval by the FERC at least once every three years. The rate review may, but does not necessarily, involve an administrative-type hearing before the FERC staff panel and an administrative appellate review. Additionally, the terms and conditions of service set forth in the intrastate pipeline s Statement of Operating Conditions are subject to FERC approval. Failure to observe the service limitations applicable to transportation services provided under Section 311, failure to comply with the rates approved by FERC for Section 311 service, and failure to comply with the terms and conditions of service established in the pipeline s FERC-approved Statement of Operating Conditions could result in the assertion of

federal NGA jurisdiction by FERC and/or the imposition of administrative, civil and criminal penalties. Among other matters, EPAct 2005 amends the NGPA to give

Table of Contents

FERC authority to impose civil penalties for violations of the NGPA up to $1,000,000 per day per violation for violations occurring after August 8, 2005. For violations occurring before August 8, 2005, FERC had the authority to impose civil penalties for violations of the NGPA up to $5,000 per violation per day. The Pelico and EasTrans systems are subject to FERC jurisdiction under Section 311 of the NGPA.

On December 21, 2007, FERC issued a notice of proposed rulemaking which proposes to require interstate natural gas pipelines and certain non-interstate natural gas pipelines to post capacity, daily scheduled flow information, and daily actual flow information. On November 20, 2008, FERC issued Order No. 720, a final rule adopting new regulations that require certain major non-interstate pipelines and interstate pipelines to publicly post certain operational and scheduling information. . Under the final rule, Order No. 720, major non-interstate gas pipelines must publicly post on a daily basis on an Internet web site (1) the design capacity of each receipt or delivery point that has a design capacity equal to or greater than 15,000 MMBtu/day, and (2) the amount scheduled at each such delivery point whenever capacity is scheduled. Order No. 720 defines a major non interstate pipeline as a company that is not an interstate pipeline and delivers annually more than fifty million MMBtu of natural gas measured in average deliveries for the previous three calendar years. The final rule exempts major non-interstate pipelines that lie entirely upstream of a processing, treatment, or dehydration plant. The implementation date is 150 days following the issuance of an order addressing the pending requests for rehearing. The Pelico and EastTrans Limited Partnership or East Trans systems are considered major non interstate pipelines and are required to comply with this rule. Compliance with this rule will result in additional administrative burdens related to the associated information technology costs.

On November 20, 2008, FERC issued an NOI to explore whether intrastate pipelines and Hinshaw pipelines providing interstate transportation and storage services should be required to post details of their transactions with shippers in a manner comparable to the posting requirements of interstate pipelines. Comments are due February 13, 2009. FERC s NOI is subject to change based on comments filed and therefore we cannot predict the scope of the final rulemaking.

The Discovery interstate natural gas pipeline system filed with FERC on November 16, 2007 a rate case settlement with a January 1, 2008 effective date. Also, modifications were made to the imbalance resolution and fuel reimbursement sections of Discovery s tariff. The settlement was approved on February 5, 2008 for all parties except ExxonMobil who contested the settlement. ExxonMobil will continue to pay the previous rates. ExxonMobil has an interruptible contract that was last used in 2006 so there will be no material impact by this outcome.

Gathering Pipeline Regulation

Section 1(b) of the NGA exempts natural gas gathering facilities from the jurisdiction of FERC under the NGA. We believe that our natural gas pipelines meet the traditional tests FERC has used to establish a pipeline s status as a gatherer not subject to FERC jurisdiction. However, the distinction between FERC-regulated transmission services and federally unregulated gathering services is the subject of material, on-going litigation, so the classification and regulation of our gathering facilities are subject to change based on future determinations by FERC and the courts. State regulation of gathering facilities generally includes various safety, environmental and, in some circumstances, nondiscriminatory take requirements, and in some instances complaint-based rate regulation.

Our purchasing, gathering and intrastate transportation operations are subject to ratable take and common purchaser statutes in the states in which they operate. The ratable take statutes generally require gatherers to take, without undue discrimination, natural gas production that may be tendered to the gatherer for handling. Similarly, common purchaser statutes generally require gatherers to purchase without undue discrimination as to source of supply or producer. These statutes are designed to prohibit discrimination in favor of one producer over another producer or one source of supply over another source of supply. These statutes have the effect of restricting our right as an owner of gathering facilities to decide with whom we contract to purchase or transport natural gas.

Natural gas gathering may receive greater regulatory scrutiny at both the state and federal levels now that FERC has taken a more light-handed approach to regulation of the gathering activities of interstate pipeline transmission companies and a number of such companies have transferred gathering facilities to unregulated

Table of Contents

affiliates. Many of the producing states have adopted some form of complaint-based regulation that generally allows natural gas producers and shippers to file complaints with state regulators in an effort to resolve grievances relating to natural gas gathering access and rate discrimination. Our gathering operations could be adversely affected should they be subject in the future to the application of state or federal regulation of rates and services. Additional rules and legislation pertaining to these matters are considered or adopted from time to time. We cannot predict what effect, if any, such changes might have on our operations, but the industry could be required to incur additional capital expenditures and increased costs depending on future legislative and regulatory changes.

Sales of Natural Gas

The price at which we buy and sell natural gas currently is not subject to federal regulation and, for the most part, is not subject to state regulation. However, with regard to our physical purchases and sales of these energy commodities, and any related derivative activities that we undertake, we are required to observe anti-market manipulation laws and related regulations enforced by FERC and/or the Commodity Futures Trading Commission, or CFTC. Should we violate the anti-market manipulation laws and regulations, we could also be subject to related third party damage claims by, among others, market participants, sellers, royalty owners and taxing authorities.

Our sales of natural gas are affected by the availability, terms and cost of pipeline transportation. As noted above, the price and terms of access to pipeline transportation are subject to extensive federal and state regulation. The FERC is continually proposing and implementing new rules and regulations affecting those segments of the natural gas industry, most notably interstate natural gas transmission companies that remain subject to the FERC s jurisdiction. These initiatives also may affect the intrastate transportation of natural gas under certain circumstances. The stated purpose of many of these regulatory changes is to promote competition among the various sectors of the natural gas industry. We cannot predict the ultimate impact of these regulatory changes to our natural gas marketing operations, and we note that some of the FERC s more recent proposals may adversely affect the availability and reliability of interruptible transportation service on interstate pipelines. We do not believe that we will be affected by any such FERC action materially differently than other natural gas marketers with whom we compete.

Interstate NGL Pipeline Regulation

The Black Lake pipeline is an interstate NGL pipeline subject to FERC regulation. The FERC regulates interstate NGL pipelines under its Oil Pipeline Regulations, the Interstate Commerce Act, or ICA, and the Elkins Act. FERC requires that interstate NGL pipelines file tariffs containing all the rates, charges and other terms for services performed. The ICA requires that tariffs apply to the interstate movement of NGLs, as is the case with the Black Lake pipeline. Pursuant to the ICA, rates can be challenged at FERC either by protest when they are initially filed or increased or by complaint at any time they remain on file with FERC.

In October 1992, Congress passed the Energy Policy Act of 1992, or EPAct, which among other things, required the FERC to issue rules establishing a simplified and generally applicable ratemaking methodology for pipelines regulated by FERC pursuant to the ICA. The FERC responded to this mandate by issuing several orders, including Order No. 561. Beginning January 1, 1995, Order No. 561 enables petroleum pipelines to change their rates within prescribed ceiling levels that are tied to an inflation index. Specifically, the indexing methodology allows a pipeline to increase its rates annually by a percentage equal to the change in the producer price index for finished goods, PPI-FG, plus 1.3% to the new ceiling level. Rate increases made pursuant to the indexing methodology are subject to protest, but such protests must show that the portion of the rate increase resulting from application of the index is substantially in excess of the pipeline s increase in costs. If the PPI-FG falls and the indexing methodology results in a reduced ceiling level that is lower than a pipeline s filed rate, Order No. 561 requires the pipeline to reduce its rate to comply with the lower ceiling unless doing so would reduce a rate grandfathered by EPAct (see below) below the grandfathered level. A pipeline must, as a general rule, utilize the indexing methodology to change its rates. The

FERC, however, retained cost-of-service ratemaking, market based rates, and settlement as alternatives to the indexing approach, which alternatives may be used in certain specified circumstances. The FERC s indexing methodology is subject to review every five years; the current methodology is expected to remain in place through

Table of Contents

June 30, 2011. If the FERC continues its policy of using the PPI-FG plus 1.3%, changes in that index might not fully reflect actual increases in the costs associated with the pipelines subject to indexing, thus hampering our ability to recover cost increases.

EPAct deemed petroleum pipeline rates in effect for the 365-day period ending on the date of enactment of EPAct that had not been subject to complaint, protest or investigation during that 365-day period to be just and reasonable under the ICA. Generally, complaints against such grandfathered rates may only be pursued if the complainant can show that a substantial change has occurred since the enactment of EPAct in either the economic circumstances of the petroleum pipeline, or in the nature of the services provided, that were a basis for the rate. EPAct places no such limit on challenges to a provision of a petroleum pipeline tariff as unduly discriminatory or preferential.

The pending FERC proceeding regarding the appropriate composition of proxy groups for purposes of determining equity returns to be included in cost-of-service based rates is also applicable to FERC-regulated oil pipelines. On April 17, 2008, FERC issued a final policy statement regarding the appropriate composition of proxy groups. FERC concluded, among other things, that MLPs should be included in the ROE proxy group for both oil and gas pipelines. FERC established a paper hearing for establishing the ROE for cases that were pending before FERC. The policy statement could result in the establishment of a higher ROE in future rate proceedings but the full effect is uncertain until the policy is applied.

Intrastate NGL Pipeline Regulation

Intrastate NGL and other petroleum pipelines are not generally subject to rate regulation by FERC, but they are subject to regulation by various agencies in the respective states where they are located. While the regulatory regime varies from state to state, state agencies typically require intrastate petroleum pipelines to file their rates with the agencies and permit shippers to challenge existing rates or proposed rate increases.

Environmental Matters

General

Our operation of pipelines, plants and other facilities for gathering, transporting, processing or storing natural gas, propane, NGLs and other products is subject to stringent and complex federal, state and local laws and regulations governing the discharge of materials into the environment or otherwise relating to the protection of the environment.

As an owner or operator of these facilities, we must comply with these laws and regulations at the federal, state and local levels. These laws and regulations can restrict or impact our business activities in many ways, such as:

- requiring the acquisition of permits to conduct regulated activities;
- restricting the way we can handle or dispose of our wastes;
- limiting or prohibiting construction activities in sensitive areas such as wetlands, coastal regions or areas inhabited by endangered species;
- requiring remedial action to mitigate pollution conditions caused by our operations or attributable to former operations; and
- enjoining the operations of facilities deemed in non-compliance with permits issued pursuant to such environmental laws and regulations.

Failure to comply with these laws and regulations may trigger a variety of administrative, civil and criminal enforcement measures, including the assessment of monetary penalties, the imposition of remedial requirements and the issuance of orders enjoining future operations. Certain environmental statutes impose strict joint and several liability for costs required to clean up and restore sites where hazardous substances have been disposed or otherwise released. Moreover, it is not uncommon for neighboring landowners and other

Table of Contents

third parties to file claims for personal injury and property damage allegedly caused by the release of substances or other waste products into the environment.

The trend in environmental regulation is to place more restrictions and limitations on activities that may affect the environment. Thus, there can be no assurance as to the amount or timing of future expenditures for environmental compliance or remediation, and actual future expenditures may be different from the amounts we currently anticipate. We try to anticipate future regulatory requirements that might be imposed and plan accordingly to remain in compliance with changing environmental laws and regulations and to minimize the costs of such compliance. For instance, we or the entities in which we own an interest inspect the pipelines regularly using equipment rented from third party suppliers. Third parties also assist us in interpreting the results of the inspections. We also actively participate in industry groups that help formulate recommendations for addressing existing or future regulations.

We do not believe that compliance with federal, state or local environmental laws and regulations will have a material adverse effect on our business, financial position or results of operations. Below is a discussion of the more significant environmental laws and regulations that relate to our business and with which compliance may have a material adverse effect on our capital expenditures, earnings or competitive position.

Air Emissions

Our operations are subject to the federal Clean Air Act, as amended and comparable state laws and regulations. These laws and regulations regulate emissions of air pollutants from various industrial sources, including our processing plants and compressor stations, and also impose various monitoring and reporting requirements. Such laws and regulations may require that we obtain pre-approval for the construction or modification of certain projects or facilities expected to produce or significantly increase air emissions, obtain and strictly comply with air permits containing various emissions and operational limitations, and utilize specific emission control technologies to limit emissions. Our failure to comply with these requirements could subject us to monetary penalties, injunctions, conditions or restrictions on operations, and potentially criminal enforcement actions. We may be required to incur certain capital expenditures in the future for air pollution control equipment in connection with obtaining and maintaining operating permits and approvals for air emissions. Following the performance of an audit by us during 2007 on facilities included in our Northern Louisiana system, we identified and subsequently self-disclosed to the Louisiana Department of Environmental Quality alleged violations of environmental law arising primarily from historical operations at certain of those facilities. We are currently involved in settlement discussions with the Louisiana Department of Environmental Quality to resolve these alleged matters. In addition, The Colorado Department of Public Health and Environment, or CDPHE, has alleged violations of the environmental permit at the Anderson Gulch Gas Plant, as a result of an inspection in January 2008. The allegations are primarily related to recordkeeping requirements. We are currently in settlement discussions with the CDPHE to resolve this matter. Aside from these enforcement matters, we believe that we are in material compliance with these requirements. We do not believe our future operations will be materially adversely affected by such requirements or enforcement matters.

Hazardous Substances and Waste

Our operations are subject to environmental laws and regulations relating to the management and release of hazardous substances or solid wastes, including petroleum hydrocarbons. These laws generally regulate the generation, storage, treatment, transportation and disposal of solid and hazardous waste, and may impose strict, joint and several liability for the investigation and remediation of areas at a facility where hazardous substances may have been released or disposed. For instance, the Comprehensive Environmental Response, Compensation, and Liability Act, as amended, or CERCLA, also known as the Superfund law, and comparable state laws impose liability, without regard to fault or the legality of the original conduct, on certain classes of persons that contributed to the release of a hazardous substance into the environment. These persons include current and prior owners or operators of the site where the

release occurred and companies that disposed or arranged for the disposal of the hazardous substances found at the site. Under CERCLA, these persons may be subject to joint and several strict liability for the costs of cleaning up the hazardous substances that have been

Table of Contents

released into the environment, for damages to natural resources and for the costs of certain health studies. CERCLA also authorizes the EPA and, in some instances, third parties to act in response to threats to the public health or the environment and to seek to recover from the responsible classes of persons the costs they incur. Despite the petroleum exclusion of CERCLA Section 101(14) that currently encompasses natural gas, we may nonetheless handle hazardous substances within the meaning of CERCLA, or similar state statutes, in the course of our ordinary operations and, as a result, may be jointly and severally liable under CERCLA for all or part of the costs required to clean up sites at which these hazardous substances have been released into the environment.

We also generate solid wastes, including hazardous wastes that are subject to the requirements of the Resource Conservation and Recovery Act, as amended, or RCRA, and comparable state statutes. While RCRA regulates both solid and hazardous wastes, it imposes strict requirements on the generation, storage, treatment, transportation and disposal of hazardous wastes. Certain petroleum production wastes are excluded from RCRA s hazardous waste regulations. However, it is possible that these wastes, which could include wastes currently generated during our operations, will in the future be designated as hazardous wastes and therefore be subject to more rigorous and costly disposal requirements. Any such changes in the laws and regulations could have a material adverse effect on our maintenance capital expenditures and operating expenses.

We currently own or lease properties where petroleum hydrocarbons are being or have been handled for many years. Although we have utilized operating and disposal practices that were standard in the industry at the time, petroleum hydrocarbons or other wastes may have been disposed of or released on or under the properties owned or leased by us or on or under the other locations where these petroleum hydrocarbons and wastes have been taken for treatment or disposal. In addition, certain of these properties have been operated by third parties whose treatment and disposal or release of petroleum hydrocarbons or other wastes was not under our control. These properties and wastes disposed thereon may be subject to CERCLA, RCRA and analogous state laws. Under these laws, we could be required to remove or remediate previously disposed wastes (including wastes disposed of or released by prior owners or operators), to clean up contaminated property (including contaminated groundwater) or to perform remedial operations to prevent future contamination. We are not currently aware of any facts, events or conditions relating to such requirements that could reasonably have a material impact on our operations or financial condition.

Water

The Federal Water Pollution Control Act of 1972, as amended, also referred to as the Clean Water Act, or CWA, and analogous state laws impose restrictions and strict controls regarding the discharge of pollutants into navigable waters. Pursuant to the CWA and analogous state laws, permits must be obtained to discharge pollutants into state and federal waters. The CWA imposes substantial potential civil and criminal penalties for non-compliance. State laws for the control of water pollution also provide varying civil and criminal penalties and liabilities. In addition, some states maintain groundwater protection programs that require permits for discharges or operations that may impact groundwater conditions. The EPA has promulgated regulations that require us to have permits in order to discharge certain storm water run-off. The EPA has entered into agreements with certain states in which we operate whereby the permits are issued and administered by the respective states. These permits may require us to monitor and sample the storm water run-off. We believe that compliance with existing permits and compliance with foreseeable new permit requirements will not have a material adverse effect on our financial condition or results of operations.

Global Warming and Climate Change

In response to recent studies suggesting that emissions of carbon dioxide and certain other gases often referred to as greenhouse gases may be contributing to warming of the Earth s atmosphere, the current session of the U.S. Congress is considering climate change-related legislation to regulate greenhouse gas emissions. In addition, at least one-third of the states have already taken legal measures to reduce emissio